

**APPROVED**

**STATE OF WASHINGTON  
STATE INVESTMENT BOARD**

**Public Markets Committee Meeting**  
**Minutes**

May 3, 2005

The Public Markets Committee met in open public session at 1:02 P.M. at the Washington State Investment Board (WSIB) office at 2100 Evergreen Park Drive Southwest, Olympia, Washington.

Members Present:      Glenn Gorton, Chair  
                          Jeff Hanna  
                          Charles Kaminski  
                          Robert Nakahara  
                          George Masten  
                          Dave Scott

Members Absent:      John Magnuson  
                          Representative Sommers

Others Present:      Joe Dear, Executive Director  
                          Gary Bruebaker, Chief Investment Officer  
                          Theresa Whitmarsh, Deputy Director for Operations  
                          Nancy Calkins, Senior Investment Officer – Public Equity  
                          Linda Lester, Investment Officer – Public Equity  
                          Liz Mendizabal, Public Affairs Director  
                          Diana Will, Senior Investment Officer – Asset Allocation  
                          Kristi Bromley, Administrative Assistant – Investments  
                          Paul Silver, Assistant Attorney General  
                          Fred Dopfel, Barclays Global Investors  
                          Stephen Rogers, Barclays Global Investors  
                          Tom Dempsey, Goldman Sachs Asset Management  
                          Patrick Sullivan, Goldman Sachs Asset Management  
                          Ric Thomas, State Street Global Advisors  
                          Neil Tremblay, State Street Global Advisors

[Names of other individuals attending the meeting are not included in the minutes but are listed in the permanent record.]

The meeting convened at 1:02 P.M. with Chair Gorton identifying members present.

**REVIEW AND APPROVAL OF MINUTES – FEBRUARY 1, 2005**

Chair Gorton announced that adoption of the February 1, 2005, Public Markets minutes would be deferred until later in the meeting.

**EDUCATION SESSION – U.S. EQUITY ENHANCED INDEXING**

Mr. Bruebaker reviewed the spectrum of risk from passive to active management and described enhanced indexing as an active management approach. He pointed out that the Board's current use of an optimized index fund for U.S. equity is also a form of active management. With rigorous risk control and a disciplined, theoretically sound approach to stock selection, enhanced indexing is between pure indexing and active management and investors have the ability to "dial in" the desired level of risk and potential added value. Enhanced indexing is expected to provide consistent but modest return premiums; have low volatility vis-à-vis the benchmark; maintain a consistent positive information ratio; and have low costs.

[Mr. Scott was in attendance at 1:05 P.M.]

Mr. Bruebaker noted that three of the WSIB managers would participate in the educational session: State Street Global Advisors will provide the historical evolution of enhanced indexing; Goldman Sachs Asset Management will discuss new ideas in enhanced indexing; and Barclays Global Investors will provide information on the use of enhanced indexing in portfolio management.

Mr. Bruebaker stated that staff's goal is to continue to work on this project and bring U.S. equity enhanced indexing back to the Committee for action later this year. The WSIB employed international enhanced indexing in 2004 as part of the international equity program restructure.

**State Street Global Advisors (SSgA)**

Mr. Thomas, SSgA, introduced himself and stated that enhanced indexing is a low risk active type of investing. He reviewed a chart depicting risk and return expectations for passive, enhanced, and active investment strategies. The characteristics of enhanced indexing include low risk and benchmark like behavior including similar market capitalization profiles, as well as similar sector and industry exposures as the underlying benchmark. Another common attribute of enhanced indexing is systematic methods to construct portfolios and select stocks.

Mr. Thomas reviewed a timeline of the history of enhanced indexing and its evolution from passive management and reviewed the advantages and disadvantages of various approaches to enhanced management.

**Goldman Sachs Asset Management (GSAM)**

Mr. Dempsey, GSAM, introduced himself and reviewed the five “Cs” of active alpha investing: confidence, correlation, cost, capacity, and capital. He stated that GSAM believes that relaxing constraints allows managers to create more efficient portfolios at higher levels of risk to meet the goal of getting more from traditional equity allocations. He reviewed market neutral investing, which allows investors to separate manager selection (alpha) decisions from asset class decisions (beta) and stressed the importance of not paying too much for alpha and alignment of interest.

**Barclays Global Investors (BGI)**

Fred Dopfel, BGI, introduced himself and stated that the title of enhanced indexing is somewhat of a misnomer; it is active management. While enhanced indexing does not have as much risk as active management, there will be down periods and skill is required to pick good active managers. He reviewed graphs showing the information ratio dispersion between upper and lower performing managers and the efficiency of enhanced indexing compared to traditional active strategies. Long-term performance demonstrates the consistency of enhanced indexing. Mr. Dopfel reviewed charts showing the portfolio impact of enhanced indexing and noted that investors must decide the appropriate risk budget for their portfolios.

The Chair invited the client service representatives from the three firms to join the presenters for a question and answer discussion. Discussion focused on capacity issues for various enhanced indexing strategies, importance of determining the appropriate risk budget for the portfolio, performance based management fee structure, fit of enhanced indexing with other portfolio management strategies, importance of selecting good managers and understanding their process, and the evolution of quantitative models.

**REVIEW AND APPROVAL OF MINUTES – FEBRUARY 1, 2005**

**Mr. Masten moved to adopt the minutes of February 1, 2005.  
Mr. Scott seconded, and the motion carried unanimously.**

**OTHER ITEMS**

There being no further business to come before the Public Markets Committee, the meeting adjourned at 2:37 P.M.